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THE

# BUSINESS REVIEW

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## HOW BANKS ADJUST THEIR RESERVES

*Management of the reserve account is a skilled art, requiring sharp pencils and agile minds. It has grown more important since higher interest rates make it more expensive to hold excess reserves. This article covers three methods of adjusting reserves: buying and selling Government securities, borrowing from the Reserve Bank, and borrowing or lending Federal funds. Use of Government securities has recently become less important. Banks are borrowing more from the Reserve Banks and using Federal funds more extensively. This reflects major changes in Federal Reserve policy.*

## SUSPENSION OF CONSUMER INSTALLMENT CREDIT CONTROLS

*Regulation W was suspended on May 7. This article reviews the reasons for and the effects of the regulation.*

## CURRENT TRENDS

*Business trends in the Third District were mixed during April. Manufacturing production declined and construction contract awards rose. Business loans were steady in May, following a decline in April.*

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## HOW BANKS ADJUST THEIR RESERVES

To the Federal Reserve official, member bank reserves are the focal point of monetary policy; they are the primary means of influencing the money supply in order to help maintain economic stability at a high level of activity. To the commercial banker, reserves are at the core of everyday operations; they go up and down when customers deposit or draw out currency, when they deposit or write checks, when the bank sells or buys securities or engages in countless other transactions which are an ordinary part of its business. Management of the reserve account is one of the skilled arts of commercial banking. It is more difficult now that interest rates on Government securities move freely than when they were being pegged by the Federal Reserve. But management of reserves is more important because higher interest rates make it more expensive to hold excess reserves at the Federal Reserve Bank.

Each bank faces different problems in managing its reserve account. No general formula can be applied to all situations. Many banks maintain a cushion of excess

Banks which keep practically all of their available funds fully loaned and invested have several ways of adjusting reserves. These methods are of two general types. The first is a redistribution of reserves, from banks with excess reserves to those in need of additional reserve funds. The second is a change in the total amount of reserves. When the individual banker adjusts his reserves, he is not primarily concerned with whether he effects a redistribution or a change in the total volume of reserves. The Federal Reserve is concerned with both a redistribution and a change in total reserves to the extent that they influence the total money supply and, hence, the total volume of spending.

Although there are other ways member banks may adjust their reserves, only three will be discussed here: (1) purchases and sales of Government securities, which, depending on whether or not they involve Federal Reserve holdings, either shift or change the volume of reserves; (2) member bank borrowing from the Federal Reserve Banks, which affects the total volume of reserves; and (3) Federal funds transactions, in which banks simply shift reserves among themselves by lending and borrowing reserves for very short periods.

### WHICH BANKS HOLD EXCESS RESERVES?

*Member Banks—Third Federal Reserve District  
(Last Half of April 1952)*

	Banks with total deposits (in millions)—							
	Under \$1	\$1- \$2	\$2- \$5	\$5- \$10	\$10- \$20	\$20- \$100	Over \$100	All banks
Of the total amount of reserves held by banks in each size group this proportion was in excess of requirements .....	27%	22%	14%	12%	9%	5%	0.4%	3%

reserves so that they do not have to make delicate adjustments in their reserve positions. Of the total reserves of member banks in the Third Federal Reserve District in the last half of April, only about 3 per cent was in excess of requirements. However, more than one-fourth of the reserves held by the smallest banks were in excess. In contrast, the few very large banks held less than 1 per cent over requirements.

### Government Securities

Throughout World War II and during most of the post-war period, banks used Government securities extensively to adjust their reserves. The types of issues they used, however, changed from time to time. In the early war period, banks used mostly Treasury bills. Through support of the bill rate at  $\frac{3}{8}$  per cent and through an option by which a bank might buy back at this rate any bills sold to the Reserve Bank, Federal Reserve policy made bills as liquid as excess reserves. Even at the peak of bank holdings of bills in mid-1943, however, bills were only used by the larger banks. Two-thirds of the member banks in the Third Federal Reserve District held no Treasury bills at all.

Treasury certificates, and even longer-term issues, gradually supplanted bills as an adjusting medium. As

long as a bank had them, the sale of bills was the cheapest way of getting reserves. But Federal Reserve support of the market made all issues, regardless of length of time to maturity, very liquid. Banks found that they could earn more and still adjust reserves easily by holding longer-term issues. Short-term Governments lost much of their importance as liquid investments for banks. By mid-1947, over 90 per cent of the member banks in this district had no bills to use in obtaining reserves; almost half of them had no bills or certificates.

### WHICH BANKS HOLD WHICH GOVERNMENTS?

#### All Member Banks—Third Federal Reserve District

	Banks with total deposits (in millions)—							
	Under \$1	\$1-\$2	\$2-\$5	\$5-\$10	\$10-\$20	\$20-\$100	Over \$100	Total
This was the percent distribution of total Government security holdings in:								
<b>June 1947</b>								
Bills .....	1	2	1	*	*	2	6	2
Certificates .....	4	7	6	9	8	9	8	8
Notes .....	5	5	6	7	6	8	3	6
Bonds .....	90	86	87	84	86	81	83	84
Total .....	100%	100%	100%	100%	100%	100%	100%	100%
<b>June 1948</b>								
Bills .....	1	2	2	2	2	5	11	5
Certificates .....	4	7	7	10	11	12	9	10
Notes .....	2	2	2	3	3	4	1	3
Bonds .....	91	89	89	85	84	79	79	82
Total .....	100%	100%	100%	100%	100%	100%	100%	100%
<b>March 1952</b>								
Bills .....	6	6	6	5	6	8	10	8
Certificates .....	3	5	5	8	8	12	9	9
Notes .....	5	7	10	15	18	20	13	15
Bonds .....	86	82	79	72	68	60	68	68
Total .....	100%	100%	100%	100%	100%	100%	100%	100%

\* Less than 1 per cent.

A number of things have happened since then to make short-terms more important. The rise in the rates on short-term Governments has made these issues more attractive for banks to buy and hold. The postwar demand for private credit caused banks to sell large amounts of Government bonds. In refunding most maturing securities with short-term issues, the Treasury has increased the concentration of the public debt in short-term securities. And, finally, the removal of the pegs on Government securities once more has made short-terms more liquid than long-terms.

These developments have revived the importance of short-term Governments in bank portfolios. Bills and certificates now comprise 17 per cent of the total Government securities held by member banks in the Third Federal Reserve District. This compares with 10 per cent

in mid-1947. Somewhat over half of the banks still hold no bills and about the same number have no certificates. This is quite different, however, from the 1947 situation already described, and even from the mid-1949 situation, in which eight out of ten banks had no bills and half of them had no certificates. Large banks still hold relatively larger amounts of short-terms than do small banks, but the difference has narrowed somewhat in the past three years.

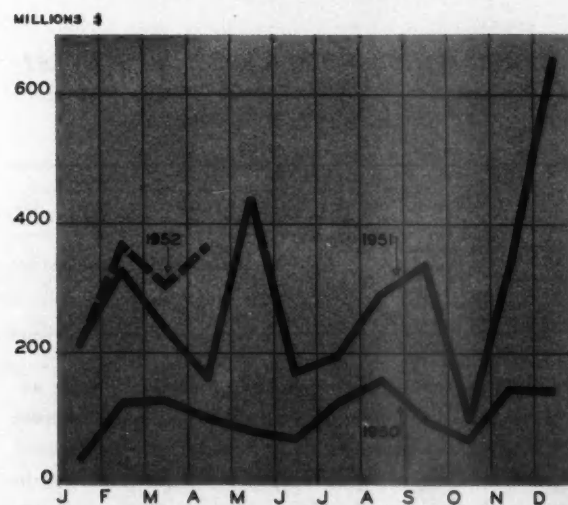
### Member Bank Borrowing

Member banks are resorting more and more to borrowing from the Reserve Banks as a means of getting reserves. This has been one result of the Treasury-Federal Reserve "accord" on debt management and monetary policies. A major objective of the "accord" is "to permit the short term (government securities) market to adjust to a position at which banks would depend upon borrowing at the Federal Reserve to make needed adjustments in their reserves."

The following chart shows that average daily borrowings of all member banks in the United States during 1951 were consistently above 1950, and thus far this year are still higher than last year.

### BORROWING AT FEDERAL RESERVE BANKS

All member banks U. S. (Daily averages)



The same tendency has prevailed in the Third Federal Reserve District. In 1951 the number of banks accommodated by this Reserve Bank was the largest since 1948,



but the average daily volume of advances outstanding was higher than at any time during or since World War II. During the first four months of this year, however, activity was running below the same period of a year ago.

Year	Number <sup>a</sup> of banks accommodated	Loans outstanding (daily average in millions of dollars)
1952 (5 months)	86	7.0
1951	148	11.3
1950	103	2.7
1949	126	3.6
1948	164	7.1
1947	153	9.9
1946	113	8.4
1945	73	8.9
1944	69	4.7
1943	50	1.7
1942	53	0.7

Only about one-fourth of all district member banks borrowed from the Reserve Bank during 1951; but, as the following table shows, all of the largest banks and one-half of the banks in the next highest size group borrowed. The large banks, of course, obtained larger dollar amounts than the smaller banks, but *relatively* less compared with their deposits. Most of the borrowing by the very large banks was for very short periods to make up temporary deficiencies. The smaller banks borrowed less frequently but for longer periods, often using Reserve Bank credit to tide them over seasonal peaks of credit demand.

#### MEMBER BANK BORROWING IN 1951 (Third Federal Reserve District)

	Banks with total deposits (in millions)—						
	Under \$1	\$1- \$2	\$2- \$5	\$5- \$10	\$10- \$25	\$25- \$100	Over \$100
This percentage of all banks in the size group borrowed	13%	17%	20%	28%	22%	49%	100%
Each bank, on the average, borrowed this much each time (in thousands).....	\$48	\$66	\$147	\$345	\$382	\$941	\$5,097
or this percentage of total deposits .....	6%	4%	4%	4%	3%	2%	3%
They borrowed this number of days during the year.....	39	34	73	83	43	65	29
and for about this number of days each time.....	15	18	15	12	13	5	2

#### Federal Funds

Banks have also been making more extensive use of Federal funds transactions—that is, very short-term borrowing and lending of excess reserves. Generally speaking, there is little information on the nature and volume of

these transactions, but considerable information on Federal funds in Philadelphia has recently become available.

In February 1949, a number of Philadelphia banks got together and set up a unique system for dealing in Federal funds. Short-term interest rates had been in an upward trend for about a year and a half, making it increasingly expensive for banks to hold excess reserves. Some of the larger institutions were anxious to employ their excess reserve funds, whenever they had them, but found it inconvenient to canvass the other banks in Philadelphia to find out which ones might need reserves temporarily.

The banks arranged with a large securities dealer, therefore, to act as a clearing house for information on Federal funds. Now, representatives of nine banks call the dealer on the telephone every morning, stating whether their banks are in the market to borrow or lend Federal funds. Usually, but not always, they indicate the amounts involved. The dealer simply puts borrowers and lenders in touch with each other. There is no charge for this service. Dealers in other cities frequently offer this same service, but Philadelphia is the only place where information is pooled by all the larger banks as a regular part of the daily routine.

Most banks review their reserve positions at the opening of business and try to anticipate the many factors which will affect their position during the day. This is easier for some banks than for others; also, some watch their reserve positions more closely than others. By about noon most banks have telephoned the securities dealer as to whether they want to borrow or lend reserves. Almost invariably the number of banks in a position to lend does not equal the number of banks wanting to borrow; usually there are more borrowers than lenders. This may well be because the anxiety of a bank to make up a small deficiency is greater than the desire of a bank to put a small excess of funds to work. Some banks try to borrow to build up excesses on days when rates are low and then run deficiencies and lend when rates are high. Because 75 per cent of borrowed capital can be added to the capital base for excess profits tax purposes, borrowing of Federal funds has the additional advantage therefore, of reducing tax liabilities. At any rate, banks which indicate they want to borrow usually do borrow; but banks which report a willingness to lend often may not lend—at least in Philadelphia. If banks are

unable to find all the funds they need or enough outlets for their excess funds, they often go to the New York market. Philadelphia transactions are made at the interest rate currently prevailing in New York.

During 1951, about three-quarters of a billion dollars of Federal funds were borrowed within the city by the nine participating banks. The volume of transactions varied widely from day to day. On a few days as much as \$10 million changed hands; on about one-fifth of the days there was no business at all. On the average, the volume of transactions approximated \$3¾ million a day. Most frequently one bank was lending and one borrowing; less frequently two banks were lending and two borrowing. A good part of the time the number of borrowers and lenders was the same, but fairly often there were more borrowers than lenders. Less frequently there were more lenders than borrowers.

Sizes of the participating banks vary so widely that loans by several of the smaller banks sometimes cannot make up a deficiency of one large bank. National banks are prohibited from lending more than 10 per cent of their paid-in capital and unimpaired surplus to any one borrower, and from having aggregate borrowings in excess of their capital stock. Since transactions in Federal funds are considered borrowing and lending (although commonly referred to as buying and selling), these restrictions—which all participating banks observe—are important factors in the Federal funds market. The lending limits of the participating banks range from less than half a million dollars to about \$5 million. The greater the differences in the sizes of participating banks the more difficult it is for such a pool to function efficiently. This, plus the fact that Federal funds operations are profitable only when fairly large amounts are involved, suggest that the arrangement is feasible only for groups of large banks. Many small country banks undoubtedly participate in the pool indirectly when they obtain funds from their correspondents which, in turn, borrow in the Philadelphia Federal funds market.

This arrangement for pooling information tends to encourage Philadelphia banks to obtain needed reserves or lend out excess reserves in the local market before going to New York. To the extent that it lessens reliance on the New York money market, it contributes in a small way toward reducing the day-to-day in- and out-flows of funds, often an important unstabilizing factor in the New York money market.

### Some Factors Which Commercial Bankers Consider

The choices which banks make among the above methods of adjusting reserves are influenced by three closely related considerations: (1) the time element, (2) costs and earnings, and (3) liquidity and attitude toward borrowing.

**Time element.** All banks face the problem of fundamental, long-run movements of funds. Some sections of the country, some towns, some banks grow faster than others. Such changes require permanent rather than temporary adjustments. Neither borrowing from the Reserve Bank nor Federal funds can be used for permanent adjustments, but Government securities do provide such a medium.

It is the shorter-run, temporary movements which we are primarily interested in here, however. Not all banks, as pointed out earlier, attempt to adjust to these shifts. Many simply hold excess reserves sufficient to absorb them. Furthermore, member banks are not required to maintain the prescribed ratio of reserves to deposits every day—only as an average during a certain period. Country banks must hold sufficient reserves to meet the prescribed ratio on the average during a half-month period; all other member banks average their reserves and deposits over a weekly period. This averaging method of computing reserve requirements tends to decrease the amount of adjustment necessary. It enables country banks to ignore day-to-day movements which cancel out over the half-month period. Some of the large banks, however, frequently go out of their way to build up excess reserves or run deficiencies in order to take advantage of expected movements of funds and interest rates later in the reserve period.

A number of banks resort to borrowing from the Federal Reserve Banks to meet intermediate-term fluctuations such as seasonal credit demands. Some banks in the agricultural sections of Lancaster County, Pennsylvania, for example, frequently borrow from the Philadelphia Reserve Bank in the fall in order to finance farmers who are fattening beef cattle, and in the spring to finance crop farmers. Some banks in seashore resorts borrow in the spring to meet demands for credit by businessmen preparing for the vacation season.

The very short-run adjustments are mostly made by larger banks, through borrowing from the Federal Reserve Banks and borrowing Federal funds. At least two

other practices compete to some extent with these methods, however. The very large banks sometimes put excess funds to work overnight by buying Government securities one day under an agreement to sell back on the next. Transactions under such agreements have no particular rate advantage compared with Federal funds; but because they are considered purchases and sales, they are not limited by the legal provisions which restrict loans to any one borrower. Amounts many times the volume of Federal funds transactions are invested in this way. Banks do not use the reverse procedure to obtain reserves nor do they make such deals among themselves; the purchase-sale agreement is a one-way street as a method of adjusting reserves. Large banks also employ excess reserves by making very short-term loans to Government security dealers, Government securities serving as collateral. The effect is much the same as a purchase-sale agreement, but amounts are limited to 25 per cent of capital and surplus to any one borrower.

**Costs and earnings.** The choice among methods of adjusting reserves also involves weighing costs against earnings. Subject to other considerations, such as liquidity and attitudes toward borrowing, banks attempt to get reserves in the cheapest way possible and to put surplus funds to the most profitable use.

A certain amount of expense is involved in keeping close watch over the reserve position and in the process of obtaining needed reserves or investing excess reserves. This element of expense is, to a certain extent, fixed; it does not rise proportionately with increases in the amount of funds involved. Moreover, the amount of funds involved must be fairly large to make close adjustments worthwhile. As an illustration, investment of \$1 million for one day at 1 per cent yields only about \$28. Large banks find it more to their advantage to manage their reserve accounts closely, therefore, than do the small banks. This is one reason why the smaller banks hold proportionately much larger excess reserves. But the choice of holding excess reserves involves a cost, just as truly as does borrowing from a Reserve Bank or obtaining reserves by any other method. This cost is measured by the rate which funds could have earned had they not been held idle. Holding excess reserves is one way of making close adjustments in the reserve account unnecessary, but it is not a cost-less way.

The cost of obtaining Federal funds (and the return on them) is the lowest of the three methods discussed.

On days when funds are plentiful and demand is light, the Federal funds rate may be as low as  $1/16$  of 1 per cent. It never drops below the point where the return is less than the cost of paper-work involved, and never rises above the rate at which banks can borrow from the Federal Reserve Banks.

The discount rate, of course, is set by the Federal Reserve authorities and can be raised or lowered depending on whether the economic situation calls for restriction or expansion of money and credit. The fact that the discount rate has remained unchanged for almost two years while rates on short-term Governments have risen, has increased the attractiveness of borrowing from the Reserve Bank in comparison with selling Governments to get reserves.

The cost of adjusting reserves by selling Governments, like the cost of excess reserves, is measured by the income which the securities would have yielded had they been retained. One of the effects of the rise in Government security rates since 1947, first in short-term issues and later in long-term bonds, has been to make it more costly to sell Governments to obtain reserves. The drop in the prices of Governments after the market was unpegged also has increased the cost of obtaining reserves by causing a capital loss on sales of Governments.

Large banks which follow very short-run movements in the money market closely are quick to take advantage of changing relationships among different rates. If rates on Treasury bills, for example, are above the discount rate, banks may invest surplus funds in bills and then borrow from the Reserve Bank if necessary. They may also invest in bills rather than lend Federal funds at a very low rate. If the Federal funds rate is above 1 per cent, however, there are advantages in lending Federal funds rather than buying bills, for a Federal funds transaction, like any loan or repurchase agreement, is contractual—the return is certain. But an overnight investment in bills can be made unprofitable by the spread between bid and asked prices (now wider than before the “accord”), or by a decline in market prices. The danger of a loss becomes greater in the case of longer-term issues. These are only a few of the cost and earnings considerations requiring sharp pencils and agile minds.

**Liquidity and attitude toward borrowing.** Unpegging Government security prices has affected the liquidity of Government securities. Liquidity of an asset depends on the ability to convert it into cash not only quickly



but without a significant loss of value. Banks can no longer be certain of getting at least par for securities they sell. In contrast to the wartime situation in which market support made all issues equally liquid, securities closer to maturity are now more liquid than longer-term issues. Although this has tended to some extent to restore the use of short-terms as a medium for adjusting reserves, uncertainties as to changes in market prices tend to favor the use of Federal funds, borrowing from the Federal Reserve Banks, and other such contractual arrangements. Moreover, the rapid expansion of bank holdings of private debt during the postwar period has reduced over-all bank liquidity. Many banks are reluctant to reduce liquidity further by selling Governments.

Banks have long been loath to be in debt for extended periods. They prefer to borrow for temporary needs only and to pay off the debt as soon as possible. Over the years this attitude has grown into a strong tradition against borrowing.

### Conclusions

Management of the reserve account is one of the difficult arts of commercial banking. Many banks avoid the need for making close adjustments by holding large excess reserves. Banks which do make adjustments—mostly the larger institutions—have several methods available. Of the three methods discussed here, the use of Government securities has recently become less important, despite a revival of the role of short-term Governments in bank portfolios. Use of borrowing from the Reserve Banks and use of Federal funds, on the other hand, have increased.

This reflects, to a considerable extent, changes in Federal Reserve policies.

The Federal Reserve is primarily interested in the total quantity of reserves. For changes in the total volume of reserves influence the total volume of bank deposits and, in turn, spending. Since the "accord" between the Treasury and the Federal Reserve was reached over a year ago, reserves have been less freely available. Because prices of Government securities now move freely in response to supply and demand conditions, banks have been discouraged from adjusting reserves by selling Governments. In an unsupported Government securities market, banks must find buyers other than the Federal Reserve. Any reserves they obtain then constitute merely a shift from other holders, not an increase in the total volume of reserves.

With reserves less freely available from other sources, banks have borrowed more extensively from the Reserve Banks. This has definite advantages from the Federal Reserve point of view. When a bank borrows from the Reserve Bank the addition to reserves is much less likely to be permanent than when a bank sells Governments to the Federal Reserve. The reason is not only that banks dislike to be in debt for extended periods but also that the borrowing transaction is for a short, fixed period and involves close contact between the member bank and the Reserve Bank; excessive borrowing can be discouraged directly, if necessary.

The increased use of Federal funds also reflects the tightening in reserves. Banks have become more anxious to economize the reserves available and to avoid the expense of holding excess reserves.

## SUSPENSION OF CONSUMER INSTALLMENT CREDIT CONTROLS

On May 7, the Board of Governors of the Federal Reserve System suspended Regulation W, the rules governing the extension of consumer installment credit. The suspension was not required by Congress. It was the Board's decision, made under its discretionary powers. The basic legislation authorizing the Federal Reserve System to regulate installment loans and sales—the Defense Production Act of 1950—has remained in effect and is still on the books as of the middle of June.

Regulation W, like many other measures which restrict long-established business practices, is a controversial measure. The regulation is a relatively new addition to the arsenal of anti-inflation weapons and it has been difficult to gauge its effect and to measure the seriousness of the administrative problems involved. Unfortunately, as long as the international situation makes the threat of inflation a continuing problem, consumer credit controls may yet have to be reimposed some time in the future. Now



that the regulation is not in effect, however, and we have reached what appears to be a lull in the upward movement of prices, it may be possible more calmly to appraise consumer credit controls as an instrument of economic stabilization.

This is not the first time that lenders and merchants have witnessed the suspension of Regulation W. The first suspension occurred in November 1947, when many of the World War II controls expired. It was reinstated in September 1948, following a period of rising prices, and again expired in June 1949. The present suspension follows a 20-month period of regulation which began shortly after the outbreak of the Korean war. While the regulation was in effect the terms under which consumer credit could be extended were sometimes relaxed and sometimes tightened. Although the particular dates of expiration and re-imposition have been the result of a combination of factors, the on-again, off-again pattern of consumer credit regulation nevertheless provides an important key to the reasons for Regulation W and to an evaluation of its usefulness.

### The Reasons for Regulation W

The regulation has been imposed and tightened at times when prices were rising and more inflation threatened. In 1941 and 1950, Regulation W was imposed in connection with intense defense and war efforts. In 1948 its imposition was related to the extraordinary situation prevailing during the aftermath of war. Generally speaking, Regulation W has been relaxed and suspended at times when it was felt that inflationary pressures had subsided; thus Regulation W—a so-called selective credit regulation—has been designed to help fight inflation in conjunction with other fiscal-monetary and direct controls. It should be considered in the light of the special circumstances—chiefly emergency situations—in which it has been used. It is not an attempt to prescribe standards of business practice or to maintain some pre-determined level of credit outstanding. It is with current changes in the level of credit outstanding and their relationship to current market conditions that the administrators of Regulation W are concerned. This is another key to an understanding of consumer credit controls.

During periods of inflation, the amount of consumer credit on the books is not nearly so important as the speed with which the total is increasing. At all times, new loans are being made and old loans are being paid

off. When consumers' incomes are rising and employment prospects are good, there is a tendency for new loans to exceed pay-offs. When this situation is combined with threats of shortages and rising prices, as was the case at the outbreak of the Korean war, the demand for consumer credit becomes very strong and the total outstanding rises rapidly. This simply means that in addition to their growing incomes, new credit is giving consumers more buying power. When there is room for expansion of production in our economy this additional stimulation can be constructive. There is, in fact, little doubt that the institution of instalment credit has helped to create the mass markets for durable consumers' goods which manufacturers require in order to put a product into mass production. But when industry is straining under a defense production program, when steel, copper, aluminum and other basic materials are short, when labor is scarce—and all of these things were true at the beginning of the current defense effort—then there is no possibility of expanding production for the purpose of turning out more washing machines and automobiles. Additional buying power available to consumers as the result of credit expansion under these conditions creates intense competition for relatively short supplies of merchandise. Prices are likely to shoot up, not only for goods at retail but, as distributors and manufacturers scramble for additional goods to restock depleted inventories, at all levels of the production and distribution process.

Increased consumer credit is regarded as *new* buying power, not merely as money transferred from one buyer to another, by reason of the fact that most of it comes ultimately from the commercial banking system, thus contributing to an expansion of deposits and of the total supply of money. The banks make many loans directly but they also provide a large amount of the funds used by finance companies and loan companies, and they frequently provide working capital which enables retailers to carry their own instalment or charge accounts. Even those loans which are made out of equity funds or borrowed savings may increase the total stream of spending in the economy, since these funds otherwise might not have gone into the market places so quickly and might have been used for the purchase of Government securities.

### Recent Experience

During 1950, instalment credit increased by \$2.6 billion, most of the gain coming between April and October.

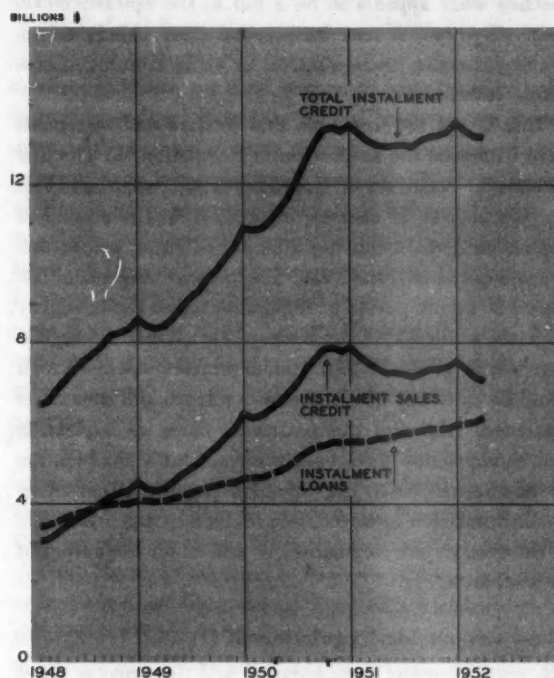
Dollar-wise, this was a very rapid expansion—the most rapid in our history. This is not to say that the increase in instalment credit was primarily responsible for the inflation which took place during that period. A look at the statistics will suffice to show that the main responsibility must be elsewhere, among a combination of many factors. It cannot be denied, however, that once it was started the buying spree and the price rises were accentuated by the creation of new consumer buying power, and economic and financial difficulties of the defense effort were thus intensified. The same effects occur during any business upturn, whether it is induced by the danger of war or not, but the likelihood of intensive periods of scare buying during periods of international tension aggravates the situation.

It is this problem to which Regulation W primarily has been directed. The increase in required down payments and monthly payments, which the regulation put into effect, would have had a tendency to reduce credit outstanding even if the rate of new instalment sales and loans had remained unchanged. The probability is that the tighter requirements actually delayed a large number of sales of consumers' durable goods during the periods they were in effect. A precise determination of the impact of Regulation W is impossible because of side effects which are not measurable and the unknown influences of other factors which contributed to the same results. The pay-off, however, is the change in regulated credit outstanding and in this regard the experience of recent months is significant.

The regulation which went into effect in September 1950 covered consumer instalment credit only—loans repayable in two or more scheduled payments, and instalment credit arising out of the sale of listed consumers' goods. Charge accounts and single-payment loans were not affected. After rising rapidly during 1949 and the first nine months of 1950, instalment credit outstanding leveled off during October 1950—the month following the effective date of the regulation—and moved irregularly downward until August of 1951, after liberalized terms prescribed by Congress went into effect. There was a moderate increase from that time until the end of the year. During the first quarter of 1952, another decline occurred, followed by a subsequent upturn in April.

As the chart shows, the rate of increase in loan credit outstanding was slowed after the regulation went into effect, but the total continued to rise. The declines

## CONSUMER INSTALMENT CREDIT OUTSTANDING



occurred entirely in instalment sale credit relating to sales of automobiles, home improvements, television sets, and other appliances. What has happened to the lines on the chart since the regulation was suspended on May 7 is not yet known. There are fragmentary reports that easier credit terms have stimulated sales in certain lines.

### The Effects of Regulation W

On its face, this is a rather impressive anti-inflationary record. Coming at a strategic point—the consumer level—there is no doubt that another billion dollars of buying power, more or less, would have made the situation more difficult. However, this record should be qualified somewhat. No one would argue, of course, that in a \$330 billion economy the relatively small amount of additional credit which Regulation W prevented was the one factor which stemmed the rising tide of prices. Moreover, there is some question about the extent to which Regulation W was aided, both by business factors and other controls, in reducing instalment credit. To some extent, consumer purchases of durable goods were probably due to fall off during 1951, anyway. Obviously, there had been many

instances of forward buying and over-buying during the early days of the Korean conflict, and some dampening of the enthusiasm for buying was likely regardless of the credit restrictions. To some extent too, other anti-inflation measures had some indirect influence. Wage and price controls may have reduced expectations of higher incomes and prices. The other actions of the Federal Reserve—the withdrawal of fixed price supports for Government securities, for instance—created a business atmosphere that was not conducive to inflationary financial expansion.

### Alternative Controls

This raises a further question with regard to the need for Regulation W. Assuming the desirability of utilizing free market forces to the fullest possible extent to bring about necessary economic adjustments, would it not be better to leave the fight against inflation completely to increased taxation or to the indirect monetary controls (such as variations in the discount rate and open market operations) exercised by the Federal Reserve System? It is generally agreed that these measures, directed as they are to the control of the volume of money and spending, get to the heart of the inflation problem. No anti-inflation program is likely to succeed without their effective use. Why become involved with the administrative problems incident to the regulation of thousands of financial institutions and merchants? This is a question that will receive continuing study. In general, the answer is that the control of inflation during emergency situations requires a flexible and many-sided program. There are limits beyond which taxation affects incentives; moreover, increased tax rates often cannot go into effect as quickly as may be necessary. The general credit instruments available to the Federal Reserve can be powerful but their use has widespread ramifications which must be taken into consideration. It is desirable that they be supplemented by measures whose impact on the economy is narrower, less powerful. In this connection also the point has been made that the nature of consumer credit makes it relatively unresponsive to over-all changes in credit policy. If it is deemed necessary to slow the expansion of consumer credit and a more specific measure such as Regulation W is not available, then a more aggressive use of general controls than is consistent with other objectives might be required and one objective or the other might have to be sacrificed; and if the

full complement of fiscal-monetary controls cannot be fully effective, then there is a tendency to place greater reliance on direct wage, price, and rationing controls which are undoubtedly more burdensome and more likely to create undesirable economic distortions than even the most specific credit regulation.

### What Regulation W Is Not

Regulation W has received some support on the grounds that it keeps credit merchants from granting instalment terms that are too lenient and does away with competition in "easy credit." This is not the purpose of the regulation: it is not a "fair trade" device. The extensive use of unsound credit terms would be a matter for concern if it should develop; but Regulation W was not concerned with it and the terms offered by individual lenders or merchants were not in themselves a consideration in deciding to impose or suspend controls. Nor does Regulation W attempt to set forth sound lending standards as such. The effect of setting a limit on terms is to narrow the differences among lenders, but it is the overall situation, not the differences, with which the administrators of the regulation were concerned.

There have been some who regarded Regulation W primarily as a device for correcting the inventory position of certain consumers' goods. The issue was never stated so crudely as this; yet many argued that the regulation might well be made more stringent when inventories were depleted and that it had to be made more lenient when inventories were rising. It is true that the inventory situation is one of the factors that must be taken into consideration in deciding whether to impose stricter instalment credit terms or to relax them. But it is only one of many factors, for the Federal Reserve is primarily concerned with the supply of credit in relation to the needs of the entire economy. Credit is fluid. Once created, regardless of its origin, it moves into every part of the financial mechanism. The effect of increasing inventories in any particular line has to be measured against the general economic situation. This became a difficult problem in 1951 when, despite rising stocks of certain consumers' goods, the outlook for defense needs was such that creation of additional consumer credit appeared to be unwise. The accumulation of inventory at some times may, in fact, be an indication of the effectiveness of the regulation and a wholly desirable development both for the purpose of storing goods for future use and

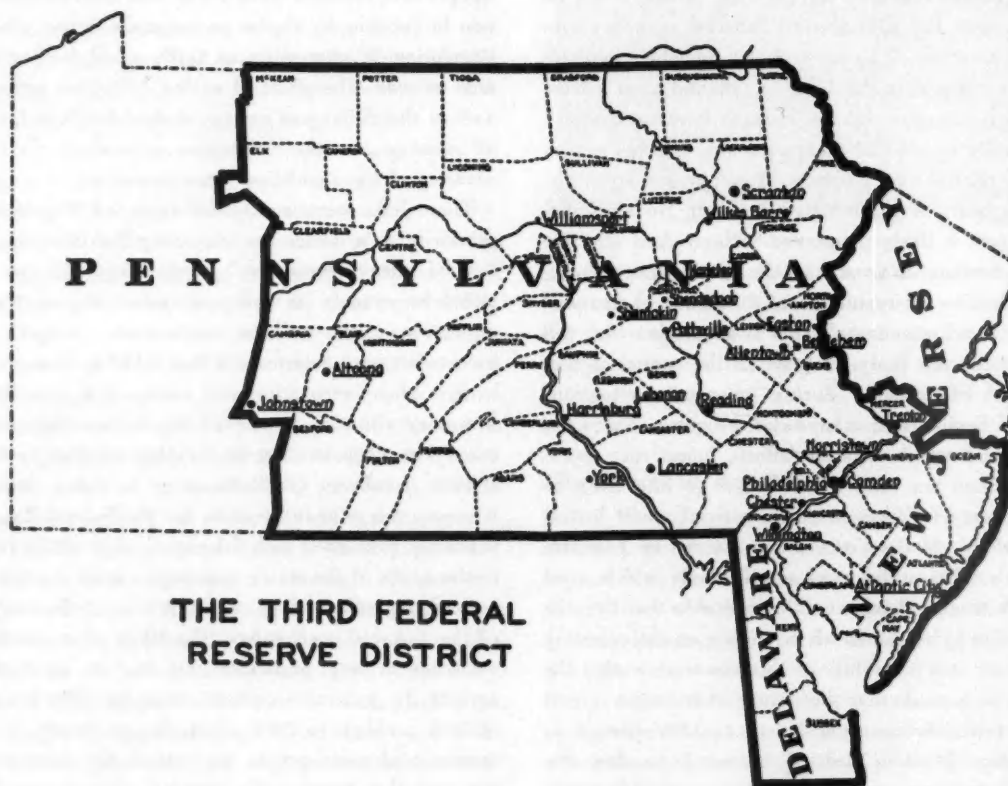


diverting productive facilities to defense production. Inventory alone is therefore an unsatisfactory guide for consumer credit regulation.

### The Future of Regulation W

The full story on consumer credit regulation cannot yet be written. The experience of recent years is insufficient to allow such controls to be given the status accorded the long-used general instruments of Federal Reserve policy; yet Regulation W has been successful enough to warrant further consideration for its use, particularly

during periods of international stress when consumer reactions to events can be sudden and sharp. By itself, its usefulness would be highly questionable. As a supplement to a well-integrated, fiscal-monetary, anti-inflation program, it appears to play a significant role, and the Board of Governors has requested that the temporary powers to regulate instalment credit contained in the Defense Production Act be retained. Future use of Regulation W requires a careful balance of the administrative difficulties it entails against the needs of the developing economic situation.





## CURRENT TRENDS

Business in the Third District continued to drift rather aimlessly during April. Declines in some lines were about balanced by gains in others.

The pace of activity in Pennsylvania factories slackened noticeably in April. After being steady for four months, industrial output fell considerably during the month. All industries but one—lumber—shared in the decline, with the major decreases being registered by apparel and furniture. Many of the declines were of a seasonal nature, but the labor-management dispute in steel also was a factor. Employment showed little change, but a reduction in the work-week was evidenced in lower payrolls.

Consumer buying was less active in April. Department store sales, after a special adjustment for the later Easter, were below those of the preceding month as well as the previous year. Inventories held by department stores remained steady and at the end of the month were 16 per cent under last year's high level.

The volume of construction contract awards registered a sharp gain for the month but failed to equal that of a year ago. All major fields shared in the increase over March, but only public works and utilities showed improvement over 1951.

The consumer price index for Philadelphia advanced for the first time in many months. Higher food prices were primarily responsible for the rise.

Business loans of weekly reporting member banks in the Third Federal Reserve District declined 6 per cent during the first five months this year, as compared with an increase of 15 per cent during the same period in 1951. For the country as a whole, business loans have declined 5 per cent thus far this year as against a 7 per cent rise in the first five months of 1951.

The nation's privately held money supply rose \$800 million in April as Treasury expenditures in excess of receipts shifted funds from Government to private accounts.

SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	April 1952 from		4 mos. 1952 from year ago	April 1952 from		4 mos. 1952 from year ago
	mo. ago	year ago		mo. ago	year ago	
<b>OUTPUT</b>						
Manufacturing production.....	-4*	-7*	-3*	-2	-4	-1
Construction contracts.....	+31	-8	-21	+18	-14	-9
Coal mining.....	+6	+11	+3	-1	-8	-2
<b>EMPLOYMENT AND INCOME</b>						
Factory employment.....	-1*	-5*	-4*	-1	-3	-3
Factory wage income.....	-5*	-4*	+1*			
<b>TRADE**</b>						
Department store sales.....	-7	-3	-5	-2	-1	-5
Department store stocks.....	0	-16		+1	-16	
<b>BANKING</b> (All member banks)						
Deposits.....	0	+9	+3	-1	+5	+5
Loans.....	+1	+6	+7	+1	+7	+8
Investments.....	-1	+1	0	-1	+4	+4
U.S. Govt. securities.....	-1	-1	-2	-1	+3	+4
Other.....	+1	+8	+7	+1	+8	+7
<b>PRICES</b>						
Wholesale.....				0	-4	-3
Consumers.....	+1†	+2†	+2†	+1	+3	+3
<b>OTHER</b>						
Check payments.....	+1	+2	+1	-1	+8	+4
Output of electricity.....	-3	+2	+2			

\*Pennsylvania

\*\*Adjusted for seasonal variation. †Philadelphia.

LOCAL CONDITIONS	Factory*				Department Store				Check Payments		
	Employ- ment		Payrolls		Sales		Stocks				
	Per cent change April 1952 from		Per cent change April 1952 from		Per cent change April 1952 from		Per cent change April 1952 from		Per cent change April 1952 from		
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	
Allentown.....	-2	-3	-5	-5						0	+1
Harrisburg.....	0	+4	-3	+6						+3	+8
Lancaster.....	0	-3	-1	-3	-7	+11	+7	-12	+3	+20	
Philadelphia.....	-1	-3	-3	0	+3	+4	+1	-17	+2	+	
Reading.....	-2	-12	-6	-19	+17	-2	+7	-18	+2	+1	
Scranton.....	+1	-5	+1	0						-7	-1
Trenton.....					+17	+1	+6	-12	+4	+5	
Wilkes-Barre.....	-1	-3	-9	-3	+2	+1	+3	-23	-7	+7	
York.....	-1	-1	-6	-2	+12	+10	+3	-13	+8	-7	

\*Not restricted to corporate limits of cities but covers areas of one or more counties.

## MEASURES OF OUTPUT

	Per cent change		
	April 1952 from		4 mos. 1952 from year ago
	month ago	year ago	
MANUFACTURING (Pa.)	-4	-7	-3
Durable goods industries	-5	-4	+1
Nondurable goods industries	-4	-10	-8
Foods	-1	-2	-3
Tobacco	-8	-10	-4
Textiles	-6	-20	-19
Apparel	-10	-21	-15
Lumber	0	-11	-11
Furniture	-10	-7	-6
Paper	-3	-15	-12
Printing and publishing	-2	-3	-1
Chemicals	-3	-2	+1
Petroleum and coal products	-1	-3	0
Rubber	-8	-8	+3
Leather	-7	-11	-12
Stone, clay and glass	-3	-14	-10
Primary metal industries	-6	-5	+2
Fabricated metal products	-4	-11	-6
Machinery (except electrical)	-3	-2	+5
Electrical machinery	-4	+2	+5
Transportation equipment	-7	+12	+25
Instruments and related products	-2	-3	+2
Misc. manufacturing industries	-3	-19	-18
COAL MINING (3rd F. R. Dist.)*	+6	+11	+3
Anthracite	+9	+16	+4
Bituminous	-10	-15	-6
CRUDE OIL (3rd F. R. Dist.)**	-2	-2	-1
CONSTRUCTION—CONTRACT AWARDS (3rd F. R. Dist.)†	+31	-8	-21
Residential	+34	-15	-30
Nonresidential	+18	-26	-33
Public works and utilities	+49	+87	+38

\*U.S. Bureau of Mines.

\*\*American Petroleum Inst. Bradford field.

†Source: F. W. Dodge Corporation. Changes computed from 3-month moving averages, centered on 3rd month.

## EMPLOYMENT AND INCOME

Pennsylvania Manufacturing Industries*  Indexes (1939 avg.=100)	Employment		Payrolls		Average Weekly Earnings		Average Hourly Earnings	
	April 1952 (Index)	Per cent change from mo. ago year ago	April 1952 (Index)	Per cent change from mo. ago year ago	April 1952	% chg. from year ago	April 1952	% chg. from year ago
All manufacturing	135	-1 -5	385	-5 -4	\$64.14	+1	\$1.64	+5
Durable goods industries	166	-1 -2	453	-5 -1	70.29	+1	1.75	+4
Nondurable goods industries	104	-2 -10	296	-5 -9	54.53	0	1.45	+4
Foods	117	-1 -2	295	+1 +4	56.59	+7	1.41	+6
Tobacco	90	-1 -3	227	-8 -6	33.15	-3	.96	+4
Textiles	68	-2 -19	199	-6 -20	52.38	-2	1.41	+2
Apparel	123	-3 -12	337	-11 -19	38.73	-8	1.15	+1
Lumber	143	-1 -10	387	+1 -7	47.11	+3	1.14	+5
Furniture and lumber products	118	-7 -9	365	-12 -3	56.90	+7	1.31	+4
Paper	136	0 -9	404	-3 -9	64.11	0	1.57	+8
Printing and publishing	118	0 -2	322	-2 +2	77.14	+5	2.00	+7
Chemicals	141	-4 -8	410	-4 +4	69.20	+4	1.62	+3
Petroleum and coal products	157	0 +1	433	0 0	83.07	-1	2.07	+3
Rubber	237	-2 -3	711	-7 0	74.48	+3	1.94	+11
Leather	82	-1 -9	214	-7 -8	44.57	+1	1.22	+1
Stone, clay and glass	131	0 -11	367	-3 -11	63.96	0	1.64	+4
Primary metal industries	142	-1 0	376	-7 -4	73.90	-4	1.91	+1
Fabricated metal products	172	-1 -8	478	-4 -8	65.94	0	1.64	+4
Machinery (except electrical)	243	0 0	703	-3 +3	73.34	+2	1.72	+5
Electrical machinery	272	-1 0	670	-3 +12	68.96	+12	1.72	+11
Transportation equipment	174	-3 +8	483	-8 +14	78.69	+5	1.92	+3
Instruments and related products	186	0 0	545	-2 0	66.66	-1	1.64	+2
Misc. manufacturing industries	124	0 -17	335	-4 -14	55.41	+3	1.35	+6

\*Production workers only.

## TRADE

Third F. R. District Indexes: 1947-49 Avg.=100 Adjusted for seasonal variation	Per cent change		
	April 1952 (Index)	April 1952 from	
		month ago	year ago
SALES			
Department stores	102	-7	-3
Women's apparel stores	90	+4	-4
Furniture stores		0*	-3*
STOCKS			
Department stores	112*	0	-16
Women's apparel stores	109	+4	-9
Furniture stores		+1*	-16*
Recent Changes in Department Store Sales in Central Philadelphia			
			Per cent change from year ago
Week ended May 10			0
Week ended May 17			-4
Week ended May 24			+2
Week ended May 31			+4
Week ended June 7			-6

\*Not adjusted for seasonal variation. p—preliminary.

Departmental Sales and Stocks of Independent Department Stores  Third F. R. District	Sales		Stocks (end of month)	
	% chg. April 1952 from year ago	% chg. 4 mos. 1952 from year ago	% chg. April 1952 from year ago	Ratio to sales (months' supply) April
				1952 1951
Total—All departments	+9	-5	-19	3.2 4.2
Main store total	+7	-6	-18	3.6 4.6
Flea goods and household textiles	-13	-15	-27	4.6 5.4
Small wares	+7	0	-9	4.2 5.0
Women's and misses' accessories	+27	-1	-10	2.8 3.9
Women's and misses' apparel	+14	0	-9	1.9 2.4
Men's and boys' wear	+21	-2	-16	4.3 6.3
Homefurnishings	-14	-15	-24	5.1 5.7
Other main stores	+25	-4	-29	3.2 5.3
Basement store total	+15	0	-20	1.9 2.7
Domestics and blankets	-3	-4	-42	3.0 5.1
Small wares	+32	-5	-12	1.7 2.6
Women's and misses' wear	+24	+2	-10	1.2 1.7
Men's and boys' wear	+20	+3	-27	2.2 3.5
Homefurnishings	-20	-8	-19	3.7 3.7
Shoes	+25	-3	-16	2.3 3.5
Nonmerchandise total	+8	+1		

## CONSUMER CREDIT

Sale Credit Third F. R. District	Sales		Receiv- ables (end of month)
	% chg. April 1952 from year ago	% chg. 4 mos. 1952 from year ago	% chg. April 1952 from year ago
Department stores			
Cash	+10	-2	
Charge account	+10	-5	+7
Instalment account	+9	-7	-6
Furniture stores			
Cash	-6	-3	
Charge account	-14	-16	
Instalment account	+12	+10	+2
Loan Credit Third F. R. District	Loans made		Loan bal- ances out- standing (end of month)
	% chg. April 1952 from year ago	% chg. 4 mos. 1952 from year ago	% chg. April 1952 from year ago
Consumer instalment loans			
Commercial banks	+33	+39	-4
Industrial banks and loan companies	+33	+34	+14
Small loan companies	+27	+16	+16
Credit unions	+38	+20	+7

## PRICES

Monthly Wholesale and Consumer Prices	April 1952 (Index)	Per cent change from		
		month ago	year ago	
Wholesale prices—United States (1947-49 = 100) . . .	112	0	-4	
Farm products . . . . .	109	0	-7	
Foods . . . . .	108	-1	-3	
Other . . . . .	113	0	-3	
Consumer prices (1935-39 = 100)				
United States . . . . .	190	+1	+3	
Philadelphia . . . . .	189	+1	+2	
Food . . . . .	228	+2	+4	
Clothing . . . . .	196	-1	-3	
Fuel . . . . .	154	0	+1	
Homefurnishings . . . . .	213	-1	-6	
Other . . . . .	174	0	+2	
Weekly Wholesale Prices—U.S. (Index: 1947-49 average = 100)	All com- modities	Farm products	Proces- sed foods	Other
Week ended May 13 . . . . .	111.6	108.3	108.7	112.9
Week ended May 20 . . . . .	112.0	110.6	108.7	113.0
Week ended May 27 . . . . .	112.0	109.6	109.1	113.1
Week ended June 3 . . . . .	111.9	110.1	109.3	112.8

Source: U.S. Bureau of Labor Statistics.

## BANKING

MONEY SUPPLY AND RELATED ITEMS United States (billions \$)	April 30 1952	Changes in—	
		five weeks	year
Money supply, privately owned .....	183.8	+ .8	+10.4
Demand deposits, adjusted .....	95.1	+ .3	+ 5.6
Time deposits .....	62.8	+ .3	+ 3.5
Currency outside banks .....	25.9	+ .2	+ 1.3
Turnover of demand deposits .....	21.3*	-1.4*	- 5.3*
Commercial bank earning assets .....	132.3	- .2	+ 7.0
Loans .....	58.2	+ .4	+ 3.9
U.S. Government securities .....	60.4	- .7	+ 2.0
Other securities .....	13.7	+ .1	+ 1.1
Member bank reserves held .....	19.9	- .3	+ 1.0
Required reserves (estimated) .....	19.1	- .3	+ .7
Excess reserves (estimated) .....	.8	0	+ .3
Changes in reserves during 5 weeks ended April 30, reflected the following:			
		Effect on reserves	
Increase in Reserve Bank loans .....		+.5	
Net payments to the Treasury .....		-.4	
Decrease in Reserve Bank holdings of Governments ..		-.2	
Decrease in other Reserve Bank credit .....		-.1	
Increase of currency in circulation .....		-.1	
Change in reserves .....		-.3	
* Annual rate for the month at 1 per cent changes from month and year ago at leading cities outside N. Y. City.			

OTHER BANKING DATA	May 21 1952	Changes in—	
		four weeks	year
Weekly reporting banks—leading cities United States (billions \$):			
Loans—			
Commercial, industrial and agricultural .....	20.6	- .2	+1.5
Security .....	2.3	0	+ .3
Real estate .....	5.7	0	+ .2
To banks .....	.5	+ .1	0
All other .....	6.1	+ .1	+ .2
Total loans—gross .....	35.2	0	+2.2
Investments .....	38.7	+ .3	+1.8
Deposits .....	83.2	+ .8	+4.3
Third Federal Reserve District (millions \$):			
Loans—			
Commercial, industrial and agricultural .....	790	- 1	+ 35
Security .....	68	+ 7	+ 17
Real estate .....	132	- 1	- 8
To banks .....	13	- 1	+ 6
All other .....	405	+ 4	+ 16
Total loans—gross .....	1,408	+ 8	+ 66
Investments .....	1,521	- 10	- 13
Deposits .....	3,248	- 23	+ 46
Member bank reserves and related items United States (billions \$):			
Member bank reserves held .....	20.1	+ .3	+1.5
Reserve Bank holdings of Governments .....	22.3	- .1	- .1
Gold stock .....	23.3	0	+1.5
Money in circulation .....	28.5	+ .3	+1.2
Treasury deposits at Reserve Banks .....	.4	- .5	- .4
Federal Reserve Bank of Phila. (millions \$):			
Loans and securities .....	1,412	+ 25	- 12
Federal Reserve notes .....	1,720	+ 2	+ 85
Member bank reserve deposits .....	888	- 41	+ 25
Gold certificate reserves .....	1,245	-139	+ 20
Reserve ratio (%) .....	46.4%	- 3.4%	+ .3%

100-100000-100

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